No. 229

In the Supreme Court of the United States

October Term, 1939

The Real Estate-Land Title and Trust Company, petitioner

v.

United States of America

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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CITATIONS

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OPINIONS BELOW

The opinion of the trial court (R. 410-417) is not reported. The opinion of the Circuit Court of Appeals (R. 459-466) is reported in 102 F. (2d) 582.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on March 13, 1939 (R. 467). A petition for rehearing (R. 469-484) was filed April 11, 1939, and was denied May 1, 1939 (R. 485). The

petition for a writ of certiorari was filed July 26, 1939. The jurisdiction of this Court is invoked under Section 240 of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Petitioner, upon its incorporation, became the owner of two duplicate title abstract plants designed and used for the same general purpose. Prior to the commencement of the taxable year one was stored, without thereafter being kept up-to-date. Does the loss of its useful value to petitioner constitute obsolescence that is deductible from gross income, or is it merely attributable to deliberate duplication of facilities for which no deduction is allowable?

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra*, pp. 9–13.

STATEMENT

This suit was instituted by the petitioner to recover income taxes paid with respect to its fiscal year ending October 31, 1928.

The petitioner is the product of a merger of three corporations which was consummated on October 31, 1927, pursuant to an agreement of October 3, 1927 (R. 31–34). Two of the constituent corporations, the Real Estate Title Insurance and Trust Company and the Land Title and Trust

Company, had been engaged in the title insurance business, and together owned two of the three principal title abstract plants in Philadelphia (R. 53). For purposes of the merger the two plants were valued at $800,000 each, although immediately prior thereto the Land Title plant had been carried at $275,000 and the Real Estate Title plant at $143,000 (R. 34–35). Before and at the time of the merger the parties thereto knew that the new corporation was about to acquire two title plants designed and used for the same general purpose (R. 35).

Both were excellent plants, and the same results could be obtained from each. Together they constituted the two most complete plants in the city (R. 116–117). A committee designated in October 1927 by the combining companies to determine which of the two plants would be used by the new corporation recommended prior to the merger that the Real Estate Title plant be tried in view of greater economy in operation (R. 49, 74–75). Accordingly, the records comprising the Land Title plant were stored in a basement, and by the latter part of October 1927 the daily additions required to keep the plant up-to-date were discontinued (R. 50). Thereafter, the only use made of those records was to ascertain what insurances were involved in connection with the forthcoming November sheriff's sales, and "from time to time, there has been, very occasionally, a check-up of some in-

formation from material in the plant to save a visit to City Hall" (R. 83).

During 1928, the petitioner attempted to sell the stored plant to a prospective purchaser for $1,000,000 (R. 61–62, 424). The good will of that plant was said to be "very substantial" (R. 140–141). There was no testimony as to any improvements in the art of title insurance or as to any new or improved methods the lack of which would result in obsolescence of a plant not having those advantages.

In its reports to the Pennsylvania Department of Revenue for the two-month period ended December 31, 1927, and for the calendar years 1928, 1929, and 1930, petitioner listed among its assets an item designated as "Title Plant," valuing it first at $1,600,000, but showing a reduction of $50,000 therefrom for each succeeding year. The reports for the years 1931 and 1932 specifically indicated that the item "Title Plant" referred to both plants, and stated that since they were duplicates "one of them was of no further use" and was being amortized (R. 42–45).

The District Court ruled that petitioner was entitled to a deduction on account of obsolescence for its fiscal year ended October 31, 1928, in the amount of $875,000 (R. 417). The Circuit Court of Appeals reversed, holding that no deduction for obsolescence was allowable.

ARGUMENT

1. Petitioner's loss of usefulness of the title plant was attributable to a deliberate duplication of facilities and was not due to obsolescence. Neither changing economic conditions nor any other circumstance within any established definition of obsolescence produced the condition for which petitioner now claims a deduction of $875,000 and a refund of over $100,000 in taxes.

The primary reason advanced for the allowance of the writ is an alleged conflict with *Crooks* v. *Kansas City Title & Trust Co.*, 46 F. (2d) 928 (C. C. A. 8th). There are, however, basic differences between the two cases. In the *Crooks* case, six abstract plants were acquired in March 1915. The deduction with respect to obsolescence was sought for four of them but was not claimed until 1921, when it was first determined that the property would become completely useless in 1930. The taxpayer asserted its right merely to a pro rata portion of the deduction which it spread evenly over the period 1921–30. Moreover, during the period 1915–21, the taxpayer actually used at least some of the assets in those four plants, and it took some three years to go through all of the various records selecting and arranging the material that could be used.

In the instant case, on the other hand, the plant was stored in a basement immediately upon acquisi-

tion in October 1927. The customary daily additions to the records required to keep the plant up-to-date were discontinued at once. The plant was not used again in connection with new searches of property but was referred to in November 1927 merely to ascertain what insurances were involved in the forthcoming sheriff's sales for that month. Both plants were in excellent condition; petitioner merely selected the one that was less expensive to operate, putting aside the other. Duplication and not obsolescence caused the loss of useful value to petitioner. The plant itself did not become useless; in fact negotiations were under way during the tax year to sell it for $1,000,000. It seems plain that the plant could not have become obsolete during the year, and that any partial reduction in value occurring through failure to keep it up-to-date was attributable to circumstances under petitioner's control.

These facts sharply distinguish the instant case from the *Crooks* case. The Circuit Court of Appeals correctly determined as a matter of law that the facts here presented do not bring this case within the statutory deduction. It did not decide that title plants cannot be the subject of obsolescence deductions; nor did it depart, as charged by petitioner, from any finding of the District Court. It merely ruled that the deduction is not allowable upon the facts shown.[1] There is no occasion for

[1] The Circuit Court of Appeals would have been justified in denying the deduction on the ground that the stored plant

this Court to grant certiorari and explore anew the facts in this record to determine whether Congress intended the deduction to apply to the peculiar situation here presented.

2. As an additional ground for the deduction, petitioner builds an argument around the word "abandonment" (Pet. 10–11). However, abandonment *per se* is not a basis for deduction, and petitioner points to no statute that allows a deduction solely by reason of abandonment. It is merely an identifiable event which may bring into play some specific statutory deduction. Thus, an abandonment may serve to render deductible a hitherto unrealized loss. But no deduction was here claimed under the separate provisions of the statute allowing deductions for losses. The only specific deduction here claimed is that based upon obsolescence, and if there has been any abandonment [8] it

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was not used in the business within the meaning of the statute. *Buckwalter* v. *Commissioner*, 61 F. (2d) 571, 572 (C. C. A. 6th). However, it assumed that for the purpose of this case there was a sufficient use to satisfy the statute but observed that "That use at most was very slight" (R. 462).

If certiorari should be granted we would undertake to support the result below upon this further ground that the plant was not employed in trade or business within the meaning of Section 23 (k) of the Revenue Act of 1928.

[8] In any event, it is clear that there was no abandonment. The plant was stored. It was valued at a million dollars during 1928, and the trial court itself even found a "salvage" value of $125,000 as of October 31, 1928 (R. 425). When such an asset is placed in storage it is a contradiction in terms to say that it has been abandoned.

at most merely implements that claim, which has been answered above.

CONCLUSION

The case depends largely upon its own facts and was correctly decided below. There is no conflict. The petition should be denied.

Respectfully submitted.

ROBERT H. JACKSON,
Solicitor General.
SAMUEL O. CLARK, Jr.,
Assistant Attorney General.
SEWALL KEY,
J. LOUIS MONARCH,
ARNOLD RAUM,
LESTER L. GIBSON,
Special Assistants to the Attorney General.

SEPTEMBER 1939.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 23. DEDUCTIONS FROM GROSS INCOME. In computing net income there shall be allowed as deductions:

(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *.

* * * * *

(f) *Losses by corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * *

(k) *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. * * *

* * * * *

Treasury Regulations 74 (1929 Ed.):

ART. 173. *Loss of useful value.*—When, through some change in business conditions, the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in such business, he may claim as a loss for the year in which he takes such action the difference between the basis (ad-

justed as provided in section 111 and article 561) and the salvage value of the property. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property has been prematurely discarded, as, for example, where an increase in the cost or change in the manufacture of any produc makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be fully explained in the return of income.

ART. 201. *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in

accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the property in the business, equal the basis of the property determined in accordance with section 113 and articles 591–604. Due regard must also be given to expenditures for current upkeep. In the case of property held by one person for life with remainder to another person, the deduction for depreciation shall be computed as if the life tenant were the absolute owner of the property so that he will be entitled to the deduction during his life, and thereafter the deduction, if any, will be allowed to the remainderman. In the case of property held in trust, the allowable deduction is to be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the will, deed, or other instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income which is allocable to the trustee and the beneficiaries, respectively. For example, if the trust instrument provides that the income of the trust computed without regard to depreciation shall be distributed to a named beneficiary, such beneficiary will be entitled to the depreciation allowance to the exclusion of the trustee, while if the instrument provides that the trustee in determining the distributable income shall first make due allowance for keeping the trust corpus intact by retaining a reasonable amount of the current income for that purpose, the allowable deduction will be granted in full to the trustee.

ART. 202. *Depreciable property.*— The necessity for a depreciation allowance arises

from the fact that certain property used in the business gradually approaches a point where its usefulness is exhausted. The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art, as where machinery or other property must be replaced by a new invention, or due to the inadequacy of the property to the growing needs of the business. It does not apply to inventories or to stock in trade, nor to land apart from the improvements or physical development added to it. It does not apply to bodies of minerals which through the process of removal suffer depletion, other provisions for this being made in the Act. (See sections 23 (1) and 114 and articles 221–257 and 611.) Property kept in repair may, nevertheless, be the subject of a depreciation allowance. (See article 124.) The deduction of an allowance for depreciation is limited to property used in the taxpayer's trade or business. No such allowance may be made in respect of automobiles or other vehicles used solely for pleasure, a building used by the taxpayer solely as his residence, nor in respect of furniture or furnishings therein, personal effects, or clothing; but properties and costumes used exclusively in a business, such as a theatrical business, may be the subject of a depreciation allowance.

ART. 206. *Obsolescence.*—With respect to physical property the whole or any portion of which is clearly shown by the taxpayer as being affected by economic conditions that will result in its being abandoned at a

future date prior to the end of its normal useful life, so that depreciation deductions alone are insufficient to return the cost (or other basis) at the end of its economic term of usefulness, a reasonable deduction for obsolescence, in addition to depreciation, may be allowed in accordance with the facts obtaining with respect to each item of property concerning which a claim for obsolescence is made. No deduction for obsolescence will be permitted merely because, in the opinion of a taxpayer, the property may become obsolete at some later date. This allowance will be confined to such portion of the property on which obsolescence is definitely shown to be sustained and can not be held applicable to an entire property unless all portions thereof are affected by the conditions to which obsolescence is found to be due.

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